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Vietnam's Economic Reforms: Much Pain, Little Gain ☐

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Summary

A series of economic reforms adopted over the past year to revive Vietnam's moribund economy have instead sparked inflation and produced bitter debate within the party and government. On one side is a group of reformers pushing for market-oriented measures to spur growth, and on the other is a more traditional, Marxist/Leninist group opposed to relaxing state control. So far the reformers have the upperhand but opponents retain sufficient influence to prevent unraveling of central planning system.

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The direction of the regime's economic policies depends on decisions made at the Sixth Party Congress later this year. The congress will approve the economic development strategy for the 1986-90 Five-Year Plan and is widely expected to ratify changes in national leadership. Leading candidates for succession include competitors from both factions in the debate on economic reforms, but we do not know which, if any, of the current leaders -- now in their late 70s and early 80s -- will step down or who will succeed them.

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The Need for Economic Reforms

Because Vietnam's dismal economic performance has been the regime's major failure, foreign observers consider the reforms to be part of the leadership's preparations for succession. The reforms have been under discussion for a number of years, but in our view both growing recognition by Vietnam's leadership of the need to try a new approach to economic management and successful experiments in southern Vietnam tipped the balance in favor of the reformers in 1985. The economy, largely isolated from Western aid and trade, had been steadily falling behind its neighbors in Southeast Asia, while reforms had dramatically improved China's economic performance, and new leaders in the USSR seemed prepared to take steps to improve Soviet economic performance. In Vietnam's case, the economy 10 years after unification was barely self-sufficient in rice production, and industrial activity remained at less than 50 percent of capacity because of shortages of electric power and raw materials, and because of transportation bottlenecks. Furthermore, lack of foreign exchange prevented Hanoi from obtaining the capital needed to expand and modernize industry (see the appendix).

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The Reform Package

The 1985 economic reform package aimed at reviving the economy by incentives to stimulate production and by introducing market influences into pricing and management decisionmaking. The series of measures included:

- Wage and price reforms.
- Decentralization of management to permit decisionmaking by enterprise managers.
- Approval of private ownership of industrial enterprises employing 10 or fewer people.
- Giving provincial governments the right to import and export.
- Proposals to set up export-processing zones and to promulgate a new foreign investment code that would permit 100-percent foreign ownership.
- Approval to cut the size of the bureaucracy by 20 to 25 percent.
- Monetary reform.

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A primary aim of the price reforms was to reduce the disparity between official and black-market prices, according to foreign observers. The wage reforms in June 1985 sought to improve productivity by changing the method of compensation for civil ser-

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[redacted]

vants and cadres. The system changed from a largely egalitarian payment-in-kind type, under which most employees received similar quantities of rice and other essential consumer goods no matter what they produced, to a 100-percent cash system in which wages are differentiated on the basis of productivity. Prices of many consumer goods were adjusted to reflect real costs and to eliminate numerous differential subsidies for the same product. Previously, for example, state stores often charged as many as four different prices for the same item, depending on the class of the consumer and whether the item was part of the basic allowance, or in excess of the purchaser's official quota.

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The Aftermath

According to a variety of press reporting, the reforms failed to produce the benefits expected by their proponents. Instead, they created considerable uncertainty, shortages of consumer goods, spiraling inflation, and extensive disarray in consumer markets. Prices, which had risen over 50 percent annually in the two years preceding the reforms, soared in the second half of 1985. According to foreign journalists, food prices by January 1986 had jumped to five or six times their September levels. The black market value of the dong fell from 40 to more than 150 per dollar, according to foreign journalists, while the official rate was pegged at 15 per dollar. [redacted]

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One observer said that, despite years of discussion, the reforms were introduced with inadequate preparation. Hanoi apparently made little provision for a smooth transition to the new policies, and enterprise managers and cadres were unable to implement coherent wage and price structures. Factory managers were unable to measure productivity or to switch abruptly from subsidies to productivity-based salaries. State stores and private traders withheld goods from the market in anticipation of higher prices, compounding shortages of many goods. [redacted]

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The regime enacted a drastic currency reform in September 1985 in a vain attempt to stem inflation and regain control over the economy from private traders. The measure called for introduction of a new monetary unit at a rate of 1 new dong for 10 old dong to reduce the amount of money in circulation. Furthermore, the government limited the amount that could be converted by individuals, families, and firms to recapture currency that had accumulated in the hands of private traders and hoarders. The currency reform failed in part because advance rumors and numerous loopholes provided opportunities to circumvent the decree and, according to foreign journalists, Hanoi failed to supply sufficient quantities of small-denomination bills. Although there were press reports late last year of large financial losses for some private traders unable to convert all their funds, the uncertainty and disarray accompanying the reform led to more shortages of goods and even higher rates of inflation as traders withheld goods from the market. According to one press report, the reform even hurt state-owned enterprises that previously had accumulated excess earnings to purchase spare parts and raw materials from private traders when adequate supplies were not available through official channels. [redacted]

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Divisions in the Leadership

Hanoi's inability to get the economy under control and stimulate development has, in our judgment, created strains within the leadership. Although the Politburo has traditionally ruled by consensus, foreign observers have noted some circumstantial evidence of factional differences within the regime. For example, Vice Premier Tran Phuong, a Chinese-trained economist who was responsible for monetary affairs, was fired in January because of the complaints about the monetary reform. The party newspaper has published numerous complaints of economic mismanagement and reported a major campaign within the government since early this year to improve the implementation of reforms. []

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Although Hanoi's top leadership has shown no public disunity on major economic issues, [] contending points of view within the Politburo as reformist versus conservative. In addition, we suspect a north-south split on economic issues in top party ranks.¹ The conservatives are headed by chief of state Truong Chinh, Army chief Van Tien Dung, and Politburo members To Huu and Pham Hung. Within the bureaucracy, key institutions such as the Army, party cadres, and civil service generally favor the conservative side. Heading the reformers are Chairman of the State Planning Commission Vo Van Kiet, a southerner who worked with party General Secretary Le Duan in the 1950s, and Nguyen Van Linh, a longtime associate of Le Duan and Vo Van Kiet, who was restored to the Politburo in 1985 after being dropped in 1982. Foreign observers describe Foreign Minister Nguyen Co Thach and Politburo member Le Duc Tho as supporters of the reforms. Le Duan, the regime's undisputed leader, has also aligned himself with the reformers to stimulate economic growth and set the stage for his successors. []

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Despite signs of possible backtracking such as the restoration of rationing of key consumer goods in January, the reformers still appear to retain the upper hand. Although Tran Phuong has been the first major political casualty of the reform effort and more firings may be in store, much of the official criticism has focused on inept implementation and not on the reforms themselves. According to foreign observers, Vo Van Kiet, the only economist in Hanoi's senior ranks since Phuong's dismissal, opposed the implementation of the currency conversion in September because he believed the economy could not absorb another shock so quickly after the wage and price reforms. Most recently, party chief Le Duan reaffirmed the decisions on price, wage, and monetary reforms at the 10th Plenum of the Party Central Committee in June 1986 and called for intensified efforts to carry out the reform program. []

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¹ Several of the leading reformers have spent large parts of their careers operating in southern Vietnam and appear to be more willing to experiment with decentralized economic decisionmaking. []


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Looking Ahead

Although debate over the reforms is likely to intensify leading up to the next party congress, we believe the Vietnamese are unlikely to significantly dismantle the centralized, bureaucratic system. The reforms announced so far allow some degree of flexibility in wages and prices and encourage productivity, but opponents of decentralization are likely to retain enough influence to prevent the emergence of a decentralized system similar, for example, to that of China. 

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Furthermore, Vietnam will probably not gain access to Western aid or investment soon because we believe Hanoi is unwilling to pull its forces out of Cambodia at the risk of a hostile regime's taking power in Phnom Penh. We expect Japanese firms to continue to supply small amounts of credits and investments, and to press for aid to Vietnam, but in our judgment Tokyo will not initiate a major aid program before Washington and Hanoi reach an accommodation. 

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As far as we can see, the only bright spot in Vietnam's economic outlook is the prospect of crude oil production from fields off the shores of southern Vietnam beginning later this year. Production of crude oil would reduce Hanoi's dependence on Moscow, but even this resource promises only limited benefits for Vietnam because a share of the crude oil output will accrue to Moscow in repayment for its economic assistance. 

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Appendix A

The Economy in Brief

Early attempts at economic reform merely halted Vietnam's post-1975 economic decline. Efforts to collectivize southern Vietnam in the late 1970s had led to declining output in both agriculture and industry. Official statistics recorded real economic growth of 5 to 6 percent annually during 1981-84 and a Vietnamese official recently claimed a 7-percent gain for 1985, but Vietnam remains Southeast Asia's most prominent economic laggard with a per capita income below \$200 per year. Rice production, which fell as a result of planning rigidities and a series of natural calamities, resumed growth in the early 1980s largely because of improved production incentives under the "contract system" adopted in 1979. Under the system, which is similar to -- but not as far-reaching as -- China's agricultural reforms, peasants are permitted to sell surplus rice on the free market after fulfilling their state procurement quotas. Industrial growth also picked up as the regime permitted more decentralization and allowed private ownership of small enterprises, a move that encouraged increased production.

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In our judgment, the success of these efforts eased the pressure on Hanoi for more far-reaching measures. Indeed, Hanoi backtracked in 1982-83 and tightened controls over private traders. The debate between supporters of bureaucratic centralism and decentralized management seasawed until the reformers apparently gained the support of Le Duan in 1985.

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Hanoi has not been able to turn to the West or Japan for assistance because most governments, which cut off aid and investment after Vietnam invaded Cambodia in 1978, are unwilling to resume official assistance until Hanoi withdraws its forces. Furthermore, Vietnam has lost access to financial resources of the IMF because of its refusal to repay arrears, a situation that we believe is unlikely to be resolved soon.

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Vietnam is heavily dependent on Soviet economic aid, which amounted to about \$1 billion annually during 1981-84. Soviet economic aid has been concentrated on infrastructure, oil exploration, and key commodities such as petroleum products, fertilizer, and foodstuffs.

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the abrupt drop in oil prices in late 1985 has raised doubts among some Vietnamese concerning future Soviet aid levels.

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